

**REPORT OF THE AUDIT OF THE
LEE COUNTY
SHERIFF'S SETTLEMENT
2005 TAXES**

June 3, 2006

CONTENTS

PAGE

INDEPENDENT AUDITORS' REPORT	1
SHERIFF'S SETTLEMENT - 2005 TAXES	3
NOTES TO FINANCIAL STATEMENT	5
COMMENTS AND RECOMMENDATIONS.....	7
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	10

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To the People of Kentucky
Honorable Ernie Fletcher, Governor
John R. Farris, Secretary
Finance and Administration Cabinet
Honorable Steve Mays, Lee County Judge/Executive
Honorable Harvey Pelfrey, Lee County Sheriff
Members of the Lee County Fiscal Court

Independent Auditors' Report

We have audited the Lee County Sheriff's Settlement - 2005 Taxes as of June 3, 2006. This tax settlement is the responsibility of the Lee County Sheriff. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for Sheriff's Tax Settlements issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the Sheriff's office prepares the financial statement on a prescribed basis of accounting that demonstrates compliance with the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the Lee County Sheriff's taxes charged, credited, and paid as of June 3, 2006, in conformity with the modified cash basis of accounting.

To the People of Kentucky
Honorable Ernie Fletcher, Governor
John R. Farris, Secretary
Finance and Administration Cabinet
Honorable Steve Mays, Lee County Judge/Executive
Honorable Harvey Pelfrey, Lee County Sheriff
Members of the Lee County Fiscal Court

In accordance with Government Auditing Standards, we have also issued our report dated December 21, 2006, on our consideration of the Sheriff's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Based on the results of our audit, we present the accompanying comments and recommendations, included herein, which discuss the following report comments:

- The Sheriff Should Require The Depository Institution To Pledge Or Provide Sufficient Collateral And Enter Into A Written Agreement To Protect Deposits
- The Sheriff Should Distribute Interest On A Monthly Basis
- The Sheriff's Office Lacks Adequate Segregation Of Duties
- The Sheriff Should Correctly Compute Penalties On Taxes Collected

Respectfully submitted,

Morgan - Franklin, LLC

Morgan-Franklin, LLC

Audit fieldwork completed -
December 21, 2006

LEE COUNTY
HARVEY PELFREY, COUNTY SHERIFF
SHERIFF'S SETTLEMENT - 2005 TAXES

June 3, 2006

<u>Charges</u>	<u>County Taxes</u>	<u>Special Taxing Districts</u>	<u>School Taxes</u>	<u>State Taxes</u>
Real Estate	\$ 423,114	\$ 222,540	\$ 430,074	\$ 182,329
Tangible Personal Property	68,663	22,257	42,148	37,813
Intangible Personal Property				29,343
Increases Through Exonerations	26	16	26	11
Omitted Taxes	531	276	539	229
Franchise Corporation	170,174	56,941	106,134	
Unmined Coal - 2005 Taxes	247	128	251	106
Oil and Gas Property Taxes	29,638	15,404	30,125	12,771
Penalties	3,829	2,006	3,947	1,681
Adjusted to Sheriff's Receipt	1,437	1,115	2,552	660
	<hr/>	<hr/>	<hr/>	<hr/>
Gross Chargeable to Sheriff	697,659	320,683	615,796	264,943
	<hr/>	<hr/>	<hr/>	<hr/>
<u>Credits</u>				
Exonerations	5,755	2,991	5,849	2,480
Discounts	7,359	3,534	6,717	3,503
Delinquents:				
Real Estate	16,163	8,412	16,429	7,003
Tangible Personal Property	77	25	47	62
	<hr/>	<hr/>	<hr/>	<hr/>
Total Credits	29,354	14,962	29,042	13,048
	<hr/>	<hr/>	<hr/>	<hr/>
Taxes Collected	668,305	305,721	586,754	251,895
Less: Commissions *	28,690	12,993	23,470	10,993
	<hr/>	<hr/>	<hr/>	<hr/>
Taxes Due	639,615	292,728	563,284	240,902
Taxes Paid	640,925	290,700	559,789	241,619
Refunds (Current and Prior Year)	945	503	1,011	527
	<hr/>	<hr/>	<hr/>	<hr/>
Due Districts or (Refunds Due Sheriff)		**		
as of Completion of Fieldwork	\$ (2,255)	\$ 1,525	\$ 2,484	\$ (1,244)
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The accompanying notes are an integral part of this financial statement.

LEE COUNTY
HARVEY PELFREY, COUNTY SHERIFF
SHERIFF'S SETTLEMENT - 2005 TAXES
June 3, 2006
(Continued)

* Commissions:

10% on	\$	10,000
4.25% on	\$	1,215,921
4% on	\$	586,754

** Special Taxing Districts:

Library District	\$	(396)
Health District		(216)
Extension District		1,816
Soil Conservation		269
Fire Acres		52

Due Districts or (Refunds Due Sheriff)	\$	<u>1,525</u>
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LEE COUNTY
NOTES TO FINANCIAL STATEMENT

June 3, 2006

Note 1. Summary of Significant Accounting Policies

A. Fund Accounting

The Sheriff's office tax collection duties are limited to acting as an agent for assessed property owners and taxing districts. A fund is used to account for the collection and distribution of taxes. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

B. Basis of Accounting

The financial statement has been prepared on a modified cash basis of accounting. Basis of accounting refers to when charges, credits, and taxes paid are reported in the settlement statement. It relates to the timing of measurements regardless of the measurement focus.

Charges are sources of revenue, which are recognized in the tax period in which they become available and measurable. Credits are reductions of revenue, which are recognized when there is proper authorization. Taxes paid are uses of revenue, which are recognized when distributions are made to the taxing districts and others.

C. Cash and Investments

At the direction of the fiscal court, KRS 66.480 authorizes the Sheriff's office to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

Note 2. Deposits

The Sheriff maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) in accordance with KRS 66.480(1)(d). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the Sheriff and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. However, the depository institution did not have a written agreement with the Sheriff securing the Sheriff's interest in the collateral.

LEE COUNTY
NOTES TO FINANCIAL STATEMENT
June 3, 2006
(Continued)

Note 2. Deposits (Continued)

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution's failure, the Sheriff's deposits may not be returned. The Sheriff does not have a deposit policy for custodial credit risk. As of November 9, 2005, \$977,641 of the Sheriff's bank balance of \$1,077,641 was exposed to custodial credit risk.

- Uninsured and unsecured \$977,641

Note 3. Property Taxes

The real and personal property tax assessments were levied as of January 1, 2005. Property taxes were billed to finance governmental services for the year ended June 30, 2006. Liens are effective when the tax bills become delinquent. The collection period for these assessments was September 27, 2005 through June 3, 2006.

Note 4. Interest Income

The Lee County Sheriff earned \$604 as interest income on 2005 taxes. As of December 21, 2006, the Sheriff's fee account is owed \$121 in interest and the Sheriff is due from the school district \$33 in interest.

Note 5. Sheriff's 10% Add-On Fee

The Lee County Sheriff collected \$10,729 of 10% add-on fees allowed by KRS 134.430(3). This amount will be used to operate the Sheriff's office.

Note 6. Advertising Costs And Fees

The Lee County Sheriff collected \$530 of advertising costs and \$723 of advertising fees allowed by KRS 424.330(1) and KRS 134.440(2). The Sheriff distributed the advertising costs to the county as required by statute, and the advertising fees will be used to operate the Sheriff's office.

Note 7. Unrefundable Duplicate Payments And Unexplained Receipts Should Be Escrowed

The Sheriff should deposit any unrefundable duplicate payments and unexplained receipts in an interest-bearing account. According to KRS 393.090, property is presumed abandoned after three years, after which time it is turned over to the Kentucky State Treasurer in accordance with KRS 393.110. For the 2005 taxes, the Sheriff had \$228 in unrefundable duplicate payments and unexplained receipts. Therefore, the Sheriff should send a written report to the Treasury Department.

COMMENTS AND RECOMMENDATIONS

LEE COUNTY
HARVEY PELFREY, COUNTY SHERIFF
COMMENTS AND RECOMMENDATIONS

As of June 3, 2006

STATE LAWS AND REGULATIONS:

The Sheriff Should Require The Depository Institution To Pledge Or Provide Sufficient Collateral And Enter Into A Written Agreement To Protect Deposits

On November 9, 2005, \$977,641 of the Sheriff's deposits of public funds were uninsured and unsecured. According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. We recommend the Sheriff enter into a written agreement with the depository institution to secure the Sheriff's interest in the collateral pledged or provided by the depository institution. According to federal law, 12 U.S.C.A 1823(e), this agreement, in order to be recognized as valid by the FDIC, should be (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

Sheriff's Response: No response.

The Sheriff Should Distribute Interest On A Monthly Basis

The Sheriff should distribute interest on a monthly basis. Per KRS 134.140(3)(b), on a monthly basis, the sheriff shall pay to the board of education that part of his investment earnings for the month which is attributable to the investment of school taxes. The Sheriff earned \$604 in interest for the entire collection period. The Sheriff did not write checks for each month but rather distributed interest to the school and fee account in June of 2006. We recommend that the Sheriff distribute interest monthly as required by KRS 134.140 (3)(b).

Sheriff's Response: No response.

LEE COUNTY
HARVEY PELFREY, COUNTY SHERIFF
COMMENTS AND RECOMMENDATIONS
As of June 3, 2006
(Continued)

INTERNAL CONTROL - REPORTABLE CONDITIONS:

The Sheriff's Office Lacks Adequate Segregation Of Duties

During our audit we noted the Sheriff's internal control structure lacked an adequate segregation of duties. This deficiency occurs when someone has custody over assets and the responsibility of recording financial transactions. In our judgment, this condition could have adversely affected the Sheriff's ability to record, process, summarize, and report accurate financial information. We recommend the Sheriff's Office obtain additional staff to divide the responsibilities or implement the following compensating controls that would help offset the lack of adequate segregation of duties:

- Cash recounted and deposited by the Sheriff
- Reconciliation of reports to source documents and receipts and disbursements ledgers by the Sheriff
- All disbursement checks are to be signed by two people and one must be the Sheriff
- All disbursements checks prepared by an employee are examined by the Sheriff for proper documentation
- The Sheriff mails disbursement
- The Sheriff or someone independent of the Sheriff's Office prepares bank reconciliations

Sheriff's Response: No Response.

The Sheriff Should Correctly Compute Penalties On Taxes Collected

During our audit, we noted that the Sheriff's computer system was not calculating the daily total tax collections correctly. Beginning with February, the Sheriff's Add-On Fee period, the computer calculated the 10% Add-On fee twice. It was included in the amounts to be remitted to the districts, as well as the amount to be remitted to the Sheriff as his Add-On Fee. When corrected, this resulted in amounts due from the districts. We recommend that this computer error be corrected prior to the current tax year penalty collections. We further recommend that daily collection report totals are reconciled to actual collections.

Sheriff's Response: No Response.

INTERNAL CONTROL - MATERIAL WEAKNESSES:

None.

PRIOR YEAR:

The Sheriff's Office Lacks Adequate Segregation Of Duties

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL
STATEMENT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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The Honorable Steve Mays, Lee County Judge/Executive
Honorable Harvey Pelfrey, Lee County Sheriff
Members of the Lee County Fiscal Court

Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of The Financial
Statement Performed In Accordance With Government Auditing Standards

We have audited the Lee County Sheriff's Settlement - 2005 Taxes as of June 3, 2006, and have issued our report thereon dated December 21, 2006. The County Sheriff's financial statement is prepared in accordance with a basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lee County Sheriff's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statement and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statement. Reportable conditions are described in the accompanying comments and recommendations as:

- The Sheriff's Office Lacks Adequate Segregation Of Duties
- The Sheriff Should Correctly Compute Penalties On Taxes Collected

Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of The Financial
Statement Performed In Accordance With Government Auditing Standards
(Continued)

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable conditions described above are not material weaknesses.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Lee County Sheriff's Settlement -2005 Taxes as of June 3, 2006 is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and which are described in the accompanying comments and recommendations.

- The Sheriff Should Require The Depository Institution To Pledge Or Provide Sufficient Collateral And Enter Into A Written Agreement To Protect Deposits
- The Sheriff Should Distribute Interest On A Monthly Basis

This report is intended solely for the information and use of management and the Kentucky Governor's Office for Local Development and is not intended to be and should not be used by anyone other than the specified parties.

Respectfully submitted,



Morgan-Franklin, LLC

Audit fieldwork completed -
December 21, 2006